Thrown-up Stone? Facts and Trends in the XXIst Century

Starting from the easily verifiable fact that times of peace are short and scattered interludes in history books, i.e. mainly wars, revolutions and crises dominate, we could say that happy are the countries that do not have the kind of history outlined above. The crisis that erupted in the third quarter of 2007 and culminated in the first quarter of 2009 provided an adequate basis in the global economy and thus for the European Union as well for accelerating the process of becoming 'unhappy'. The discussions related to the crisis and crisis management were contributed to, inter alia, by the Economic Policy Roundtable held on 15 April 2011. This event has traditionally been hosted by the Faculty of Economics and Business Administration of the University of Debrecen every spring since 2007. Speakers at this year's conference – which was entitled *Thrown-up stone? Facts and trends in the XXIst century* – included *István Benczes, Dóra Győrffy, László Muraközy, Júlia Király, Ádám Török* and *István György Tóth.* The roundtable discussion at the end of the day was moderated *by József Péter Martin.*

■ In his presentation entitled *European economic governance: challenges and question marks*, István Benczes outlined the path that the European Union, which is currently engaged in crisis management and seeking the way out, was compelled to take since the contract-level declaration of the Economic and Monetary Union. The crisis highlighted the necessity of new economic governance, the two pillars of which are crisis management and crisis prevention. Regarding crisis management, the speaker reminded that prevention had not worked, and one could encounter many free-rider phenomena. In particular, compliance with the provisions of the Stability and Growth Pact was not among the comfortably exercisable social virtues. Therefore, the risk of contagion continues to exist. Consequently, there is no other way for the Union but to help its Member States without leaving much room for moral hazard and without jeopardising the provisions of the Treaty (such as the non-rescue clause). The case of Greece is a plastic illustration of the subject; István Benczes emphasised that maintaining a stable debt ratio would require primary balances that do not seem to be realistic. Let us also add that the current situation of Greece is a huge credibility problem and a test of the euro area, but the really puzzling question is – even in the event of a default or debt rescheduling – what will make the Greek economy grow again in the near future. In the area of crisis prevention, the speaker primarily mentioned the focus on macroeconomic stability, the promotion of competitiveness as well as fiscal policy coordination and discipline. István Benczes also emphasised that for the sake of sustainability the current solution proposals (creation of a European Stability Fund, envisaging the prospect of debt settlement) require changes in the existing system, which relies on the impossible trinity of denial: no withdrawal, no default and no rescue.

Dóra Győrffy's presentation entitled *Rule of law and economic crisis* rightly called attention to the fact that the economic crisis had a fundamental effect on the opinion formed of constitutionality and on the related attitudes. One of her fundamental assertions is that the weak institutional system, including the weakness of constitutionality, plays an important role in the evolution of the susceptibility to crisis; with an increase in uncertainty the time horizon of the stakeholders' decisions becomes shorter. Based on very deep theoretical foundations, the speaker guided the audience into the world of bad and good circles potentially developing between the institutional system and individual decisions, and also called attention to the economic policy consequences. In connection with the new EU Member States on the way to the adoption of the euro, Dóra Győrffy strived to prove that the environment of confidence is a factor of key importance. According to her hypothesis, the adoption of the euro – as long-term economic policy orientation – can be expected in countries with a high level of confidence; *a contrario*, a low-confidence environment is characterised by short-term policies' gaining ground. The speaker endeavoured to demonstrate the soundness of her hypotheses relying on the World Governance Indicators survey of the World Bank. This indicator of institutional quality made three groups visible. Euro area members Estonia, Slovakia[1] and Slovenia had the best indicators; the second group comprises the countries that use a fixed exchange rate policy (Bulgaria, Latvia and Lithuania), which renounced independent monetary policy. The third group includes the Czech Republic, Hungary, Poland and Romania, where a floating exchange rate system is applied, but the euro has not yet been adopted. In the speaker's interpretation, short-term orientation means that where the lower level of public debt was coupled with relatively higher private debt, individuals – in the institutional framework – preferred the short term by increasing their willingness to become indebted. Obviously, preferability postulates that economic policy turns a blind eye to it. In addition, the speaker also gave voice to the empirical fact that during the crisis the flexible exchange rate system proved to be the most useful, although the protective umbrella of the euro was also of great help. She considered the currency board the worst performing one, which, according to Dóra Győrffy's presentation, did not allow any adjustment. We have to point out that the more increased penetration of fiscal discipline can still be considered a positive effect of the institutional strait-jacket of the currency board lasting for nearly ten years, which is also confirmed by the fact that the budget had been nearly balanced or had even often shown a surplus. Without this, currency crisis would already have taken place, as the current account deficit (25% of GDP in 2008) already exceeded the psychological threshold of around 10% that leads to currency crisis long ago, which was very well documented in economic history.

László Muraközy's presentation *Where is the modern state headed?*, inviting to seek ways and means, covered several interesting aspects. The speaker attempted to analyse the above question focusing on Europe in a way as to also decipher the most important messages of the time horizon from the 1970s to 2007. As his presentation revealed, the illustration of the expenditure side of public finances and the debt paths in crisis periods leads us to the consideration that a real turn in the role assumed by the state can only be perceived from the nineties on. At the same time, László Muraközy emphasised that significant differences had developed in Europe by then, which seem to be spectacular especially in terms of the nature of the state. In his opinion, the interpretation of these differences requires the transcension of one-dimensional theories, i.e. it requires an interdisciplinary interpretation. We have known since *Vörösmarty* that daydreaming is the depraver of life; therefore, in connection with the presentations of László Muraközy it would be pseudo-rational to daydream and expect him to give highly simplified answers. More precisely, by evoking Orwell's spirit, he refrains from both the libertarian approach that makes the small state appear as if it was the guarantee for the most important worldly goods and from the views that prejudge the large state. What really matters is not the size dimension of the state, but its efficiency, performance and the quality of regulation, which are influenced by the quality of governance. He illustrated the latter with the help of the World Governance Indicators of the World Bank, which were also used in Dóra Győrffy's presentation, first with regard to groups of European countries, then separately for the former socialist countries. One of his important findings was that South European countries lag behind in terms of all the indicators applied (corruption, freedom of speech, political stability, legality, quality of regulation and efficiency of governance). In the speaker's opinion, the governments of countries faced serious challenges in the period preceding the 2008 crisis as well (ageing society, globalisation, excessive size of the public sector). Admittedly, progress in the public sector issue would require the retailoring of fiscal footprints. Of course, fiscal discipline also serves (would serve) the purpose of being able to keep the role of the government within certain limits. This is a key circumstance, especially if one takes into account the fact of economic history that, as witnessed by the literature on crises, the emergence of crises always seems to have been preceded by a significant growth of the public sector.[2] According to László Muraközy's presentation, the size of European states cannot as a general rule be considered optimal, although the turn of the millennium brought a trend of improvement, mainly in the Scandinavian countries, Germany and Austria. Demography is already an issue of fundamental significance, but – as the presentation revealed – the picture will be even gloomier by 2050, when pension and health expenditures are expected to exceed 25 per cent of GDP. In the global competition, the utilisation of the potential in governance and quality institutional operation will be of key importance. Nevertheless, managing the debt crisis and minimising the probability of recurrence remain problems to be solved. Accordingly, it is no coincidence chance *Reinhart* and *Rogoff* (2011:4) already mention the period between 2007 and 2018 as the 'decade of debt'.

▫In her presentation entitled *Crisis prevention – new experiments*, Júlia Király continued the undertaking she had embarked upon in 2010 of dealing with the future, taking account of the state of affairs related to the financial intermediary system. The speaker emphasised that an initiative – recently launched – such as the wish regarding the necessity of macroprudential policy and its filling with actual content is in fact considered rehabilitation.[3] The explicit definition of macroprudential policy is in a rather embryonic state. Nevertheless, it seems to mean that in addition to the price stability objective (which, for example, guides the European Central Bank as well), monetary policy should also add issuance and financial stability to its imaginary list of tasks, applying an array of macroprudential instruments for this purpose. In Júlia Király's opinion, measures are required that may simultaneously contribute to the reduction of procyclicity (time dimension) and strengthen the resilience of the system (cross-sectional dimension). Since the crisis there has been an increased need to support the establishment and strengthening of a systemic approach equipped with the monitoring of systemic risks.[4] The beacons indicating the forthcoming problem need to be taken into account both in the case of the time dimension (for example, current account deficit, credit boom, macroeconomic imbalance) and the cross-sectional dimension (level of concentration, existence of focal points etc.). On the other hand, rules that facilitate countercyclicity and represent the alternative application of microprudential instruments seem to be beneficial. At the same time, the speaker placed great emphasis on the fact that the financial intermediary system is affected not only by the macroprudential rules, as the effects of monetary and fiscal as well as microprudential and social policies should also be considered. In her anatomy pertaining to the current condition of the Hungarian banking sector, Júlia Király advanced the argument that capital situation and liquidity can be considered expressly adequate, but on the other hand, it is a paralysed banking system even in international comparison (with frozen corporate and household loans, deteriorating portfolios as well as decreasing and shortening external funds). The speaker noted that behind the paralysis the economic policy measures that affect the financial intermediary system in a negative manner are not necessarily well-founded. It was not addressed during the presentation, but we may implicitly presume that no matter how macroprudential rules change, it is highly certain that the practice of inflation targeting cannot be replaced overnight with, let's say, another seven outcome variables and eight instruments. In all probability, we are facing a slow and organic learning process.

■The presentation by Ádám Török was entitled *Institutional conditions of the prevention of debt crises*. In line with the message of the aforementioned Reinhart and Rogoff (2011), its initial assertion was that the acceleration of the indebtedness process can now be observed in an increasing number of OECD countries as well. Moreover, the number of those potentially affected by the debt crisis is also growing. In 2008, solvency problems were experienced in new EU Member States (Latvia, Hungary and Romania), but by 2010 there were old Member States as well (mainly Portugal, Italy, Ireland, Greece and Spain) that were classified as countries threatened by the debt crisis. Presumably, the method of crisis management through fiscal stimulus may even strengthen this trend.[5] Ádám Török strived to raise relevant questions from the aspect of international finances, legal economics and game theory, including, for example: 'To what extent does debt collection depend on international law?', 'When can a credible determent work?' or 'What are the main domestic and international risks of debt crises?' The legal approach called attention to the fact that the legal aspect of debt settlement still contains open issues. And today the debt settlement methods applied in Java in the XVth century – when the insolvent debtor became the slave of the creditor – cannot be used any longer; the issue of enforcing one's rights is still relevant. The speaker also noted that the precise definition of debt crisis also requires correction, as recently not only the situation when a country announces its insolvency has been considered a debt crisis, but also the case of a major increase in the risk premium. In connection with regional debt paths, political economics literature that mentions the existence of political cycles which fundamentally determine the developments in deficits and debts was inevitably referred to. Approaching elections, politicians are inclined to become fiscal alcoholics like some kind of heroes of an operetta, significantly exacerbating deficit and debt ratio positions. In connection with the cycle, Ádám Török pointed out the well-known phenomenon of time inconsistency. At this point the speaker emphasised that as an independent institution had been established in the field of monetary policy, a similar initiative should be encouraged in the area of fiscal policy as well. The reason for the delegation is the aforementioned time inconsistency. Nevertheless, the speaker also mentioned that it is easier to determine an inflation target than it is the level of the long-term debt ratio of the given economy that is thought to be 'optimal'. And as the levels of budget deficit and debt may also be interpreted as the embodiment of a social choice of values, the authority of a fiscal institution like this cannot be very diverse. Namely, the legislature should not transfer the political and legal responsibility to the independent budgetary institution. Ádám Török also indicated in his presentation that both objective and subjective factors play a decisive role in the debt risk assessment of a country; they may strengthen or attenuate one another. He fortified his assertion with various indicators that illustrate fiscal performance. Namely, there seems to be a lack of harmony between the primary gap and the developments in default risk premiums, which is attributable to a serious hiatus in the transparent operation of fiscal policy, for example in Hungary as well. Accordingly, it is necessary to set up an independent and unbiased institutional anchor in those countries where investors may doubt that the government is committed to fiscal sustainability and transparency. In Ádám Török's opinion, an institution like this should deal with the impact analysis of fiscal policy decisions and the consistency analysis of the economic role of the government by always bearing transparent fiscal policy in mind.

■ *Structure of society and economic policy: determinants of the demand for state protection* was the title of István György Tóth's presentation, in which he called attention to major research subjects, including 'Why do good politicians choose bad economic policies?' and 'Why do seemingly clever voters elect bad politicians?'. In connection with raising these issues, the speaker emphasised the role of ad hoc factors, personal competences as well as of social structure, institutional and cultural determination. Following the introductory thoughts he sensibly limited his presentation to two subjects, eventually targeting the determinants of the demand for state intervention and the examination of the discernible changes in the social composition of Hungarian voters. Analysing the reasons for the major demand for redistribution and state paternalism, the speaker said that proceeding from the inequalities one may encounter intermediary mechanisms such as interests, values and perceptions, which are placed between demographic variables and redistribution attitudes. The presentation made it clear that the demand for redistribution is fundamentally determined by individual self-interest. He mentioned further influencing factors, including the following:

- a more adverse financial situation is coupled with a higher appetite for redistribution;
- those who expect a deterioration in their financial situation have a more positive opinion of state redistribution (protection);
- those who think that the poor are responsible for their own problems are less fond of redistribution;
- those who believe that poverty has social reasons have a higher demand for redistribution;
- a higher degree of the perception of poverty and social tensions entails a stronger preference for redistribution.

As it was seen from the international comparison, and illustrated in connection with Hungary as well, the greater the disparities at the level of poverty are, the stronger the demand for redistribution is. *Szalai* (2007) already pointed out that the proportion of those who live from the welfare provision system in Hungary increased, and substitution between income from work and social allowance gained ground.[6] It is therefore not surprising that the power of the *status quo* could only increase. According to István György Tóth's explanation, those who live from state redistribution show higher commitment to redistribution, which is primarily determined by the preferences of the middle strata.

The question 'Why did the crisis affect Europe more seriously?' posed by József Martin during the *roundtable discussion* made it clear that the questions and doubts related to the crisis continue to prevail in conversation. When focusing on the European consequences of the crisis, one should not forget in what *pre-crisis* starting position it was compared to its competitors. Europe lags far behind the United States in productivity. Its dynamics of catching up have shown serious deterioration since the second half of the nineties. Moreover, the gap is widening; Europe is falling behind in terms of innovation performance as well, while Asia continues to close the gap. Well, these were the conditions when the crisis arrived, which called for a uniform and quick reaction. The participants in the roundtable discussion emphasised that although the United States responded earlier, until now Europe has had better results in terms of the stability of the financial system. The EU reacted later than the United States, the background of which – in the opinion of the participants in the roundtable – was mainly attributable to the fact that while the United States was afraid of recession, Europe was afraid of inflation. In connection with the delay one should not forget that the possibility of hysteresis is encoded in the system, as one cannot speak about a completely implemented and mature Economic and Monetary Union and especially not about political union, which, in an ideal case, could bring the promise of a uniform, faster and harmonised economic policy. During the analysis of the respective backgrounds of the Irish and Greek examples and touching upon the developments in Spain and Portugal, the speakers emphasised that the events both warrant caution and point to the necessity of interventions to be performed as soon as possible.

Presumably, Nietzsche's *eternal recurrence* thesis will continue to be valid, i.e. crises will most probably come again, and the real question is *what regulatory and institution-building consequences and approaches are being innovated* by the current crisis. For example, it was visible that the fine tunability of the sophisticated methodology that has been applied widely to date (e.g. DSGE) has been unable to convince economics as a whole.[7] Accordingly, where questions of great importance also begin is whether mainstream economics will move in the direction of a kind of Leontief's (1971) way of thinking (chronic scepticism regarding the buildability of general and consistent models) or in a direction characterised by the effort to create a better model. In the latter case, the model should allow not only a meticulously precise description of the current economic situation, but its power of prediction should also improve significantly, in line with Friedman's (1966) expectation.

Many believe that the future will bear somewhat of a resemblance to the past; in light of this we may formulate our closing hypothesis that the Economic Policy Roundtable, which has a past of five years, will continue to have a great future.

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Notes

[1] Dóra Győrffy expressively discussed the relationship between confidence and economic policy in the case of Slovakia in her study published in the volume entitled Present, the past of future. See: Győrffy (2009)

[2] See Chu (2007)

[3] See, for example, the conference entitled Macro-Prudential Policies: Asian Perspectives, organised by the IMF and held in Shanghai in October 2010.

[4] During her presentation, Júlia Király mentioned that there had been problems with the recognisability of the latest crisis that reached the European markets as well. The most important message is that it is not sufficient to look at the developments merely from the aspect of fundamentals and macro statistics, but it would also be sensible to take systemic risk into account. In the speaker's opinion, it was possible to know exactly where the contagion was coming from, but it remained latent for a long time. In critical periods, things often have to be viewed from a longer distance and sometimes through other kinds of eyeglasses. As it was possible to completely – and subsequently – interpret the ageing Beethoven's often angry behaviour and inability to cooperate only when a medical examination revealed that he had in fact been suffering from serious lead poisoning for years.

[5] Examining the fiscal stimuli weighing on the EU and its Member States, it is worth recalling the Great Depression and the fact that the New Deal culminated in 1934, and fiscal expansion amounted to around one and a half per cent of GDP. On the other hand, it also bears mentioning that the magnitude of expenditure reduction in 1935 was nearly the same. See also Romer (2009).

[6] At the time of the democratic transformation, 47 out of 100 households partly ensured their monthly living from welfare provision, which was the exclusive source for 26 households. However, by 2005, already 65 out of 100 households lived on social provision partly, and 46 households entirely, every month (Szalai, 2007).

[7] Regarding the deceptive nature of the unconditional belief in DSGE and the relevant problems, see Caballero (2010).

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